

MINUTES OF THE REGULAR MEETING
OF THE BOARD OF TRUSTEES OF THE EMPLOYEES' RETIREMENT SYSTEM (ERS)
OF THE STATE OF HAWAII
HELD ON MONDAY, SEPTEMBER 12, 2011
CITY FINANCIAL TOWER, 201 MERCHANT STREET, SUITE 1935
HONOLULU, HAWAII

ROLL CALL

Trustees present: Mr. Colbert Matsumoto, Chair
Ms. Jackie Ferguson-Miyamoto
Mr. Emmitt Kane
Mr. Vincent Barfield
Ms. Pili'alo'ha Lee Loy
Mr. Jerome Rauckhorst
Mr. Wayne Yamasaki
Mr. Kalbert K. Young (11: 35 a.m.)

Attorney present: Mr. Brian Aburano, Deputy Attorney General

Attorney excused: Ms. Diane Kishimoto, Deputy Attorney General

Staff: Mr. Wesley Machida, Administrator
Ms. Kanoe Margol, Assistant Administrator
Mr. Rodney June, Chief Investment Officer
Mr. Vijoy Chattergy, Investment Specialist
Mr. Karl Kaneshiro, Enrollment, Claims & Benefits Branch Chief
Mr. Keith Miyamoto, Information System Branch Chief
Ms. Donna Curry, Program Specialist
Ms. Gerri Konishi, Member Home Loan Assistant
Ms. Jaime Hirata, Recording Secretary
Ms. Wanda Kugiya, Secretary

Guests: Mr. Leon Wechsler) L.R. Wechsler, Ltd.
Mr. Meir Schecter

Mr. Neil Rue) Pension Consulting Alliance, Inc.
Ms. Kay Ceserani

Mr. Andy Betz) Macquarie Funds Group (USA) Inc.
Mr. Kurt Faulhaber

Mr. Jim Proud) Heitman Capital Management
Mr. Paul Rezens

QUORUM

A quorum being present, Chair Matsumoto called the meeting to order at 9:44 a.m.

APPROVAL OF MINUTES –
SPECIAL MEETING, JULY 13, 2011

On a motion made by Ms. Ferguson-Miyamoto, seconded by Mr. Kane, and unanimously carried, the Board approved the minutes of the Special Board meeting of July 13, 2011.

PRESENTATION OF THE RESULTS OF
THE EFFICIENCY STUDY BY L.R.
WECHSLER, LTD.

Mr. Leon Wechsler and Mr. Meir Schecter of L.R. Wechsler, Ltd. (LRWL) presented the results of the efficiency study of the ERS and their recommendation as to how the ERS's retirement process, particularly the "finalization process" can be made more efficient.

The project was named the "Efficiency Study" and began on February 28, 2011. It focused on the ERS's 2-step benefit "finalization process" by gathering and analyzing information to develop a report with recommendations as to how this process can be made more efficient.

LRWL noted that there is room for improvement in the finalization process and discovered the following main issues with the current situation:

- At the time a member retires, data needed to accurately process the member's retirement is either unavailable, incomplete, or inaccurate
- Inefficient processes that center around work reporting and employer communications – not to date; received after the person retires

LRWL also noted that the finalization of teachers and professors are done outside of the Vitech System (V3) which also creates inefficient data and processes.

As such, LRWL proposed the following primary recommendations:

- Construct employment history
 - Paper vs. electronic; change from 2-step to 1-step: currently some employers provide personnel information via paper which are not imaged and not processed until retirement; help employers gain capability to submit information electronically
 - Use V3 to determine missing personnel information
- Clean historical data
 - Fix incorrect data that is in wrong pay period (lagged)
- Enhance work reporting
 - Do not allow data into V3 unless it is valid to prevent bad data from getting into the system
- Perform teachers/professors calculations within V3
 - Allow programming entry of teacher schedules into V3 (currently calculated manually via spreadsheets)
- Obtain data needed at the time of retirement from employers
 - Request needed data items upon receipt of retirement

application and provide electronic means to enter data

- Reconcile member contributions
 - Clean up data and construct employment history

LRWL noted that the primary recommendations are expected to take 18 months to complete at a total cost of about \$2.4 million. The following may be implemented to support the recommendations:

- changes to V3
- identify change management issues
- electronic support to employers
- project management: measurement, communications, support
- provide members with annual benefit statement, self-service, and enhance retirement seminars
- legislative recommendations - charge interest on contribution deficiencies, change cost of purchase of professional development time, and reinstate/increase incentives for employers to supply data to ERS in a timely fashion

LRWL concluded that the ERS would benefit from these recommendations in the following ways:

- reduced cost of monies spent on resources (Contractors)
- improved service to members
 - more rapid and efficient retirement
 - less backlog
- perception of the ERS
 - better aligned with the Best Practices of other leading firms in similar business as ERS

On a motion made by Ms. Ferguson-Miyamoto, seconded by Mr. Yamasaki, and unanimously carried, the Board approved the recommendation and the report on the Efficiency Study.

The Administrator noted that plans to have an online member self-service system are progressing and expects the site to go live in November 2011. There being no further discussion, LRWL concluded its presentation at 10:33 a.m. and did not return for the remainder of the meeting.

AMENDMENT OF THE AGENDA

ESTABLISHMENT OF AN AD-HOC COMMITTEE TO MANAGE THE REQUEST FOR PROPOSALS FOR GENERAL INVESTMENT CONSULTANT, REAL ESTATE CONSULTANT, AND PRIVATE EQUITY CONSULTANT

On a motion made by Ms. Ferguson-Miyamoto, seconded by Mr. Rauckhorst, and unanimously carried, the Board amended the agenda to establish an ad-hoc investment consultant committee to evaluate the appropriate consultant structure and the responses to the Request for Proposals (RFP) for (1) general investment consultant, (2) real estate investment consultant, and (3) private equity consultant.

On a motion made by Mr. Yamasaki, seconded by Mr. Rauckhorst, and unanimously carried, the Board established the ad-hoc investment consultant committee (Committee). Chair Matsumoto then appointed the following Trustees as members of the Committee:

- Emmit Kane, Chair
- Vince Barfield
- Piliuloha Lee Loy
- Jerry Rauckhorst
- Kalbert Young

Chair Matsumoto noted that the purpose of the Committee would be to evaluate the responses of the RFP and make a recommendation of finalists to the Board for the Board's review and appropriate action.

PRESENTATION OF THE STRATEGIC INVESTMENT PLAN FOR 2011 – 2014 BY PENSION CONSULTING ALLIANCE

Mr. Neil Rue and Ms. Kay Ceserani of Pension Consulting Alliance (PCA), Inc., ERS' general investment consultant, presented the report of the ERS' Strategic Investment Plan for 2011 - 2014. The report focuses on risk management and class structuring issues with recommendations from the ERS' general investment consultant, PCA, PCA Private Equity, and ERS' real estate investment consultant, Courtland Partners. The report focuses on risk management issues and class structuring issues for public equity, public fixed income, real return, real estate, private equity, and covered calls, by providing time lines, plans, and strategic considerations.

NEW BUSINESS

COVERED CALLS POLICY

The ERS' Chief Investment Officer (CIO), Mr. Rod June, reported on the proposed Investment Policy for the Covered Calls strategy. It is designed to control risk of the strategy.

On a motion made by Ms. Ferguson-Miyamoto, seconded by Ms. Lee Loy, and unanimously carried, the Board adopted the Investment Policy for the Covered Calls strategy, to be included as part of the ERS Investment Policy and Procedures Manual.

INVESTMENT MANAGER "WATCH
STATUS" – ATALANTA SOSNOFF
CAPITAL

PCA reported on the status of the ERS' active large cap equity investment manager, Atalanta Sosnoff Capital (Atalanta). Since being placed on the "watch status" at the November 2010 Board meeting due to material underperformance, Atalanta has continued to underperform by a material amount. As of June 30, 2011, Atalanta fallen through the ERS short-term relative to benchmark Watch List Criteria. PCA also mentioned that Atalanta's ownership change in 2010 may be a contributing factor on their work and time commitments to the ERS.

PCA recommended the Board extend Atalanta's watch status by up to six months, during which PCA and ERS will further assess Atalanta's performance.

On a motion made by Ms. Lee Loy, seconded by Mr. Rauckhorst, and unanimously carried, the Board approved the recommendation to extend Atalanta's watch status by up to six months.

EXECUTIVE SESSION

On a motion made by Ms. Lee Loy, seconded by Mr. Rauckhorst, and unanimously carried, the Board entered into Executive Session to:

- approve Executive Session Minutes of the Special Meeting of July 13, 2011
- pursuant to HRS § 92-5(a)(8), to hear a status report from Heitman Capital Management
- pursuant to HRS § 92-5(a)(8), to hear a status report from Macquarie Funds Group (USA) Inc. on HiTip
- pursuant to HRS § 92-5(a)(4), to consult with the Employees' Retirement System (ERS) attorneys on questions and issues pertaining to the Board's powers, duties, privileges, immunities and liabilities with respect to the ERS's funded status
- pursuant to HRS § 92-5(a) and (8), to consider preliminary actuarial studies regarding actuarial methods that impact the ERS's financial statements and to consult with the Board's attorneys on questions and issues pertaining to the Board's powers, duties, privileges, immunities and liabilities with respect to actuarial methods
- pursuant to HRS § 92-5(a)(4), to consult with the ERS's attorneys on questions and issues pertaining to the ERS's powers, duties, privileges, immunities and liabilities with respect to the Hybrid Plan Upgrade Program; appropriate action

APPROVAL OF EXECUTIVE SESSION
MINUTES –
SPECIAL MEETING, JULY 13, 2011

RECESS

Chair Matsumoto called at recess at 10:47 a.m.

RECONVENE

Chair Matsumoto reconvened the meeting at 10:55 a.m.

EXECUTIVE SESSION TO HEAR A
STATUS REPORT FROM HEITMAN
CAPITAL MANAGEMENT REGARDING A
HAWAII REAL ESTATE OPPORTUNITY

EXECUTIVE SESSION TO HEAR A
STATUS REPORT FROM MACQUARIE
FUNDS GROUP (USA) INC. ON HITIP

(Mr. Kalbert Young joins the meeting at 11:35 a.m.)

RECESS

Chair Matsumoto called for a recess at 11:43 a.m.

RECONVENE

Chair Matsumoto reconvened the meeting at 12:00 p.m.

EXECUTIVE SESSION TO CONSULT
WITH THE ERS' ATTORNEYS ON
QUESTIONS AND ISSUES PERTAINING
TO THE ERS' POWERS, DUTIES,
PRIVILEGES, IMMUNITIES AND
LIABILITIES WITH RESPECT TO THE
ERS'S FUNDED STATUS

Mr. Lewis Ward, the ERS' actuary from Gabriel Roeder Smith &
Company (GRS) joined the meeting via Skype to report on the ERS'
85th annual actuarial valuation for the year beginning June 30, 2010.

EXECUTIVE SESSION TO CONSIDER
PRELIMINARY ACTUARIAL STUDIES
REGARDING ACTUARIAL METHODS
THAT IMPACT THE ERS'S FINANCIAL
STATEMENTS AND TO CONSULT WITH
THE ERS'S ATTORNEYS ON QUESTIONS
AND ISSUES PERTAINING TO THE
BOARD'S POWERS, DUTIES,
PRIVILEGES, IMMUNITIES AND
LIABILITIES WITH RESPECT TO
ACTUARIAL METHODS

EXECUTIVE SESSION TO CONSULT
WITH THE ERS'S ATTORNEYS ON
QUESTIONS AND ISSUES PERTAINING
TO THE ERS'S POWER, DUTIES,
PRIVILEGES, IMMUNITIES AND
LIABILITIES WITH RESPECT TO THE
HYBRID PLAN UPGRADE PROGRAM.
(HPUP)

EXIT EXECUTIVE SESSION

On a motion made by Mr. Yamasaki, seconded by Ms. Ferguson-Miyamoto, and unanimously carried, the Board emerged from Executive Session.

AUDITS OF THE ERS AND DRAFT FINANCIAL STATEMENTS

The Administrator provided an update on the Audit Committee meeting held on September 6, 2011. Highlights included:

- KPMG LLP presented the audit and financial statements of the ERS for the year ended June 30, 2009
- Total assets of about \$10.5 billion as of June 30, 2009 compared to \$8.9 billion as of June 30, 2008
- Audit for the year ended June 30, 2010 (2010 Audit) will start October 2011; KPMG will do the 2010 audit concurrently with the audit for the year ended June 30, 2011, although the financial statement for each year will stand alone. KPMG will strive to have a draft of the 2010 financial statements ready by summer 2012 for the Audit Committee to review
- timing and efficiency of the 2010 and 2011 audits may be affected by the change of investment managers, on-going member claims, and \$260 million added to contribution revenues received from the Hybrid plan upgrade program

ERS staff and the Audit Committee recommend to the Board to approve the audit of the financial statements of the ERS as of and for the year ended June 30, 2009.

On a motion made by Mr. Kane, seconded by Ms. Lee Loy, and unanimously carried, the Board approved the audit of the financial statements of the ERS as of and for the year ended June 30, 2009.

REQUEST FOR PROPOSALS (RFP) FOR INTERNAL AUDIT CONSULTANT SERVICES

ERS staff and the Audit Committee recommended to the Board to authorize the issuance of a request for proposal (RFP) for internal audit consultant services to assist the ERS with the establishment of an internal audit function.

On a motion made by Ms. Lee Loy, seconded by Mr. Rauckhorst, and unanimously carried, the Board authorized the issuance of the RFP for internal audit consultant services, as described in the scope of services, subject to any required approval by the Governor.

ADMINISTRATOR'S UPDATE ON THE
2012 LEGISLATIVE BILLS AND
PROPOSALS AFFECTING THE ERS

The Administrator reported that the following are possible 2012 legislative proposals that should be reviewed by the Legislative Committee for disposition to the Board:

- (1) IRS tax requirements
- (2) HRS § 88-24 -- trustee requirement for investment experience
- (3) HRS § 88-21.5 -- changes to definition of compensation for purposes of calculating pension benefit
- (4) HRS § 88-63 -- limit accumulated unused sick leave that can be used as years of service for calculating pension benefit payments
- (5) HRS § 88-21 -- reduce interest rate on contributions for existing employees from a future date forward
- (6) Act 163, SLH 2011 housekeeping measure

After discussion, on a motion by Mr. Yamasaki, seconded by Ms. Lee Loy, and unanimously carried, the Board approved referral of items (1), (2), and (6) to the Legislative Committee, as well as anti-spiking legislation and recommendations from the Efficiency Study.

ADMINISTRATOR'S UPDATE ON THE
ERS ACTION PLAN

The Administrator provided an update on his Action Plan as of September 12, 2011:

- Legislative: tracking proposals and bills; set-up next Legislative Committee meeting
- General Employee Trustee Election
- Changes to computer system may be costly; need budget approval

NEXT BOARD MEETING –
OCTOBER 11, 2011

Chair Matsumoto announced that the next Board meeting is scheduled for October 11, 2011.

MEETING ADJOURNED AT 12:49 P.M.

On a motion made by Ms. Lee Loy, seconded by Ms. Ferguson-Miyamoto, and unanimously carried, the Board adjourned the meeting at 12:49 p.m.

REDACTED

Wesley K. Machida
Administrator

WKM:jh